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SOME LEGAL PROBLEMS OF RAILROAD VALUATION.

No more gigantic task has ever been imposed upon an administrative body than that imposed upon the Interstate Commerce Commission by President Taft, when he signed, upon March 1, 1913, the much discussed amendment to the Interstate Commerce Act providing for the valuation by the Commission of all the common carriers in the United States.[1] The valuation of the common carriers involves, aside from the infinite labor of valuing lands, terminals, rights of way, yards, track, roadbed, buildings, shops, equipment, tools, supplies and all other physical properties of the railroads, a consideration of most perplexing and important engineering, economic and legal problems, which must be solved by the Commission before an intelligent result can be presented to Congress. Although the engineering problems will be difficult, owing to the seemingly unlimited variety of ideas prevalent among engineers in regard to any particular subject, the solution of the legal problems, or what they have aptly called "quasi-economic" problems, will be of vastly more importance in determining the final valuations.

A student of the law upon this subject cannot but be impressed by the meagreness of the authorities upon which the Commission can rely in making its valuation. This is probably due to the fact that the courts have been careful, if not wary, of deciding more than the actual point involved in any particular case, and that in venturing to decide the legal points involved, the courts were entering upon a comparatively new and unknown field of legal controversy, and have realized the dangerous results to the railroads and the public from ill considered or hastily written precedents. A brief reference to the history of the legal controversies

[1] Sixty-second Congress, Sess. III, c. 92.

between the railroads and the rate making power will show the comparative novelty of the questions involved.

After the Civil War, and up to 1887, when the Interstate Commerce Commission was created, the freight traffic manager of a railroad was an industrial and commercial czar. He could ruin or make individual shippers, business firms or even towns or cities by aiding or handicapping their rivals. Whether or not the present legislation is fair to the railroads and to the present generation of railroad men is a much discussed question, but at all events, the railroads are at present reaping the whirlwind sown a generation ago.[2]

In 1876 occurred the epoch making decision of the Supreme Court of the United States in *Munn* v. *Illinois*[3] in which it was decided that a state might fix maximum charges of common carriers and of various other businesses devoted to public use and affected with a public interest. The decision was in relation to the power of the State of Illinois to fix rates to be charged by warehouse proprietors, and the principles of the decision, though dissented from by some of the judges of the court, have now become elementary in our law. Any doubt as to whether the decision applied specifically to railroads was dispelled by the decision in the famous "Granger Cases"[4] decided at the same term of the Court in regard to the maximum rates for transportation by railroads prescribed by the Iowa Legislature of 1874.

Since that time the right of a state to fix the maximum rates to be charged for the transportation of persons and property within its own jurisdiction, unless restrained by some charter or contract, or unless what is done amounts to a regulation of foreign or interstate commerce, has been unquestioned. No limitations upon the effect of the decision were suggested, and its sweeping effect was pointed out by Justice Field in his dissenting opinion in *Stone* v. *Wisconsin*:[5]

"The questions thus presented are of the gravest importance, and their solution must materially affect the value of property invested in railroads to the amount of many hundreds of millions, and will have a great influence in encouraging or repelling future

[2]An adequate idea of the conditions existing at that period may be obtained from Mr. A. B. Stickney's instructive book "The Railway Problem," (1891) D. D. Merrill Company, St. Paul.

[3](1876) 94 U. S. 113.

[4]Chicago, B. & Q. R. R. Co. *v.* Iowa (1876) 94 U. S. 155; Peik *v.* Chicago & N. W. Ry. Co. (1876) 94 U. S. 164.

[5](1876) 94 U. S. 181, 184-5.

investments in such property. They were ably and elaborately argued by eminent counsel, and nothing was omitted which could have informed or enlightened the court. The opportunity was presented for the court to define the limits of the power of the State over its corporations after they have expended money and incurred obligations upon the faith of the grants to them, and the rights of the corporators, so that, on the one hand, the property interests of the stockholder would be protected from practical confiscation, and, on the other hand, the people would be protected from arbitrary and extortionate charges. This has not been done; but the doctrine advanced in *Munn* v. *Illinois, supra,* p. 113, has been applied to all railroad companies and their business, and they are thus practically placed at the mercy of the legislature of every State."

Justice Field hinted, however, of constitutional limitations upon the powers of a state, from which the railroads might derive a ray of hope,[6] and several years later his ideas prevailed in the Court, and in the "Railroad Commission Cases,"[7] the Supreme Court announced:

"From what has thus been said, it is not to be inferred that this power of limitation or regulation is itself without limit. This power to regulate is not a power to destroy, and limitation is not the equivalent of confiscation. Under pretence of regulating fares and freights, the State cannot require a railroad corporation to carry persons or property without reward; neither can it do that which in law amounts to a taking of private property for public use without just compensation, or without due process of law."[8]

From the language of the Court, the railroads might gather that the state could "regulate" ("regulate" usually is synonymous with "decrease") rates to a certain point marked X, but that to pass this point was confiscation. The finding of the point X was a nice problem for the Railroad Commissions, the public, the railroads and the railroad investor to ponder over.

The Mississippi Act creating a Railroad Commission, (well drawn by able, prophetic lawyers, in view of subsequent decisions), which was upheld in the decision, set forth a standard by which that illusive point X between regulation and confiscation could be determined, and directed the Commission to reduce the tariffs of the railroads so as to provide an income "sufficient to allow a fair and just return on the value of the railroad, its appurtenances and equipment."

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[6] P. 186.

[7] (1886) 116 U. S. 307.

[8] Railroad Commission Cases, *supra,* 331.

Here we have for the first time a reference to the valuation of the railroads as a controlling factor in limiting the power of a state to reduce rates of transportation.

In considering the relation of railroad rates to the value of the railroads, one cannot but be impressed by the theory of the close relationship between the two urged by the courts as a restriction upon the power of a state, when, as a matter of practical rate making, probably no individual rate or any collection of rates in force upon any road in the country has been adopted by the railroads themselves with any regard to valuation or capitalization. The theory upon which rates are made may be beyond all understanding except for the initiate, but in the main the controlling factors have been the cost of the service to the railroad and the value of the service to the shipper, modified, perhaps, by competitive conditions. So eminent an authority as Chairman Martin A. Knapp of the Interstate Commerce Commission testified in 1899:

"I have not seen any instances in which the rates have seemed to much depend upon or be influenced by the capitalization of the road. Q. You have never seen such a case? A. I have not. The capitalization of the railroad I think cuts no figure in the rate question."

The practical railroad point of view was stated before the Interstate Commerce Commission, by President Ripley of the Atchison, Topeka & Santa Fe Railroad in 1911:

"I think that the cost of the service is only one of the items to be considered in the making of a reasonable rate, and not a very important item at that,—either the cost of service or the returns made on capital. I think that while they may be considered under certain conditions they are remote. * * * I think that the cost of the service has very little consideration in the making of rates. Rates are made without a consciousness on the part of the carrier's agent of the return these rates will bring. * * The maker of the rate in the first instance must make the rate such as to permit of the freest intercourse and the freest interchange of commodities in the country, regardless of capital, regardless of cost,—almost regardless of cost, but entirely regardless of capital."

Then, being asked as to whether the Commission should make rates by use of this railroad method, he said:

"I think they (the Commission) should consider the value of the service first and foremost and leave the cost and value of the properties to altogether secondary consideration."

He also stated that in his view the making of freight rates

"has not, never did have, never will have, never ought to have, any relation to the capitalization of the railroads."[9]

Whatever may be the views of practical railroad men, and although it may be conceded that the valuation of a railroad plays absolutely no part in the fixing of any particular individual rate, the courts have closely held to the opinion that the rates as a whole in force upon a railroad could not be lowered below a point insufficient to yield a fair return upon the property. The courts have almost as consistently refused to make any hard and fast rule as to how that valuation was to be determined, but have decided each case as it arose upon the circumstances of its particular facts, and have been careful to avoid establishing any fixed or general basis of valuation.

Indeed, no authoritative legal statement whatever as to any method of determining the valuation of a railroad was made until 1898, when in the decision of the famous case of *Smyth* v. *Ames*,[10] the Court said, in an oft quoted statement:

"We hold, however, that the basis of all calculations as to the reasonableness of rates to be charged by a corporation maintaining a highway under legislative sanction must be the fair value of the property being used by it for the convenience of the public. And in order to ascertain that value, the original cost of construction, the amount expended in permanent improvements, the amount and market value of its bonds and stock, the present as compared with the original cost of construction, the probable earning capacity of the property under particular rates prescribed by statute, and the sum required to meet operating expenses, are all matters for consideration, and are to be given such weight as may be just and right in each case. We do not say that there may not be other matters to be regarded in estimating the value of the property. What the company is entitled to ask is a fair return upon the value of that which it employs for the public convenience. On the other hand, what the public is entitled to demand is that no more be exacted from it for the use of a public highway than the services rendered by it are reasonably worth."

Mr. William J. Bryan, in his argument for the State of Nebraska in that case, urged that the value of the railroads should be measured by the cost of reproduction of their physical properties. No such ruling was made by the Court, which regarded the cost of reproduction simply as one element in a number from which value should be ascertained. The Court refuses to emphasize any

[9] *In re* Advance of Freight Rates, Western Case (1911) 20 I. C. C. Rep. 307, 348.

[10] (1898) 169 U. S. 466, 546.

one element as controlling, and even hints of other elements of valuation than those enumerated, leaving value to be determined from a consideration of all the facts in the best judgment of the court or judicial body making the valuation.

The Act providing for the valuation of the railroads by the Interstate Commerce Commission does little more. No rule or standard by which the Commission shall proceed in the valuation is prescribed, nor is emphasis given to any one element of value over any other, the draftsmen of the bill keeping closely under the sheltering wing of *Smyth* v. *Ames*,[11] in requiring investigations into certain elements of valuation, but leaving the far more difficult problem of reconciling the various items and of determining value from them all, to the judgment of the Interstate Commerce Commission. Thus the duty is imposed of ascertaining "original cost," the history and organization of the company, the moneys received from issues of stocks, bonds and other securities, the financial arrangements under which the issues were made, the gross and net earnings of the road, the original cost of all lands and rights of way, and their present value, and separately the original and present cost of condemnation and consequential damages, the value of lands received by way of donation from individuals or governmental sources, the cost of reproduction less depreciation and an inventory value of physical property; and the suffering Commission is entrusted with the task of presenting "an analysis of the methods by which the several costs are obtained, and the reason for their differences, if any." The Commission is likewise required to report separately "other values, and elements of value, if any, of the property of such common carrier, and an analysis of the methods of valuation employed, and of the reasons for any differences between any such value, and each of the foregoing cost values." From the labyrinth of figures, analyses and conflicting theories, the Commission must extricate itself, and present to Congress annually the "value of all the property owned or used by every common carrier subject to the provisions of the Act."

The value thus obtained, or the amount of any element of value such as cost of reproduction, or inventory value, must, necessarily, from the nature of the investigation be a matter of opinion and not of fact. Such elements can only be obtained from the opinion evidence of engineers, and without any intention of offending that learned profession, it is safe to predict that upon every

[11] *Supra.*

item of value hopelessly conflicting opinions will be given by able and experienced engineers. Assuming that the Commission can accurately ascertain the total of certain elements of value, at every stage of the valuation, there is also opportunity for bitter controversy between lawyers as to the propriety of including or excluding certain items when found. And the controversy will wage principally in regard to the intangible elements of value, such as the allowance of items for increment in land values, "contingencies," "interest during construction" and "discount on securities" in ascertaining the cost of reproduction, and principally, whether the value of franchises shall be included, and whether value as a whole should be the market value of the road appraised as a going concern.

One of the first legal difficulties, however, will be that of proving the "initial cost" to date of the railroads. As stated recently by the Interstate Commerce Commission:

"In point of fact, this item is not reliable. The present railway systems in Official Classification territory have usually been formed by the combination of a large number of smaller railroads which were built as independent properties. The Baltimore & Ohio system, for example, embraces more than one hundred such properties. The only information that the present system has of the 'original cost' of construction is that derived from the books of the various companies which have been absorbed. These books were seldom accurately kept and often represent as money what was, in fact, something else. The beginnings of these accounts, therefore, are very imperfect and unreliable."[12]

Whether or not satisfactory evidence can ever be presented to the Commission from the books of the railroads as to their cost to date, in view of the later decisions of the United States Supreme Court, were it not for the mention of the initial cost in the *Smyth* v. *Ames* decision, it would seem to many lawyers that the "original cost" was totally irrelevant upon the question of present value. Many of our roads were built years ago, when the cost of labor and materials was cheaper than now, while others could be more cheaply built at the present time by reason of improved facilities available for the work, such as use of track laying machines, instead of laying track by hand. It is the "present value" which must be obtained, and the initial cost is relevant only as bearing on that value, for it has been held that where the property of a public service corporation has appreciated in value, it is the

[12] *In re* Advance of Freight Rates, Eastern Case (1911) 20 I. C. C. Rep. 257-258.

increased value which must be considered for the rate-making, and not the cost.[13]

This rule should work both ways. If a railroad was built at a cost of $40,000 per mile in 1880 and could be duplicated to-day for $20,000 per mile, (which would be a most unusual case), should the public to-day pay rates sufficient to yield a return upon the initial cost, because of the road's age? No fault can be found with the language of a Minnesota decision:

"No guaranty was ever given by the state to the old road that the price of materials and the cost of construction would not decline, or that capital invested in railroads should not be subject to like vicissitudes as capital invested in other enterprises. Modern improvements and other causes have continued to reduce the cost of construction of all kinds of new plants, and to reduce the value of old plants, or render them wholly worthless, and the state did not guarantee that those causes should not in like manner affect the capital invested in railroads."[14]

In any event, the difficulty of proof of initial cost will be practically insurmountable because of incomplete records, changes of ownership, re-organizations, receiverships and foreclosures, and other vicissitudes through which practically all of our great systems have passed.

"Cost of reproduction" has been generally accepted as one of the most important elements entering into valuations and a number of the states have made valuations for various purposes of the railroad systems within their borders upon that basis. The "cost of reproduction" presents opportunities for bitterly contested opinion evidence of engineers rather than legal controversies, except as to the allowance or disallowance of certain items of intangible value, such as "contingencies," "interest during construction" and "discount on securities."

In practically every engineering estimate, an item is included for contingencies, for the majority of engineers seem habitually to under-estimate rather than over-estimate the cost of any proposed undertaking. Apt illustrations are the original estimates and the final costs of the Panama Canal and the Pennsylvania Railroad station in New York City. To cover unforeseen developments necessitating an increase in cost, an item for "contingencies" is usually included either at five or ten per cent of the estimated cost. In the valuation of the Minnesota railways by the State

[13]Willcox *v.* Consolidated Gas Co. (1909) 212 U. S. 19.

[14]Steenerson *v.* Great Northern R. R. Co. (1897) 69 Minn. 353, 72 N. W. 713.

Warehouse Commission, an item of five per cent upon the entire cost of reproduction was allowed by the engineer of the Commission:

"The preliminary field work and surveys upon which these estimates are based is usually hurriedly made; very little, if any, time is given to considering the character of the material to be encountered in the grading other than a very rough and necessarily uncertain classification of it, or of the character and extent of the water courses and drainage areas, and except for the very important bridges, little information is at hand as to the requirements of foundations, etc., so that with these and other factors representing an indeterminable element of cost, there is every justification for a contingent item both in theory and in practice."[15]

The item has been excluded from the "cost of reproduction" of a telephone plant in a rate case upon the theory that no such element of uncertainty is present when the plant is actually in existence,[16] and allowed in the valuation of a railroad in a rate case tried by the writer,[17] but its propriety has not been passed upon affirmatively by the Supreme Court, which noted that such an item was included in the valuation of a water works plant, but refused to pass upon the propriety thereof;[18] and approved certain valuations of railroads containing an item for "Contingencies" in the recent "Minnesota Rate Cases"[19] without specific comment. Whether the item for contingencies will be allowed by the Inter-State Commerce Commission must be determined by the Commission itself in the absence of controlling judicial authority.

During the time any railroad is being constructed there is a loss of interest upon the capital invested, which, in the estimates of the cost of any engineering work, is allowed and provided for by the item "interest during construction." Until the opening of the railroad for business, the projectors thereof can receive no return upon the capital invested and loss of interest on the capital engaged in the undertaking must be allowed for as a practical cost.

"Interest during construction" was allowed by the court below in the "Minnesota Rate Cases"[20] and was also allowed in the valua-

[15]Supplement to Annual Report of Railroad & Warehouse Commission of Minnesota (1908) p. 27.

[16]Pioneer Tel. & Tel. Co. *v.* Westenhaver (1911) 29 Okla. 429, 118 Pac. 354.

[17]Montana, W. & S. R. R. Co. *v.* Morley (1912) 198 Fed. 991.

[18]City of Knoxville *v.* Knoxville Water Co. (1909) 212 U. S. 1.

[19]Simpson *v.* Shepard (1913) 230 U. S. 352.

[20]Shepard *v.* Northern Pacific Ry. Co. (1911) 184 Fed. 765, 809.

tion of the Minnesota railroads by the Minnesota Commission at the rate of four per cent of the estimated "cost of reproduction,"[21] upon the estimate that the necessary funds for entire construction would be employed fully one-half of the estimated time of construction. The decision of the Supreme Court in the Minnesota Rate Cases[22] as usual avoided ruling specifically upon this item because its decision was not necessary for the decision of the case.

Modern business is done almost entirely upon borrowed money. Rarely has any railroad in the United States been built except with money derived from the sale of its bonds, and rarely, if ever, has a railroad in its constructive days been able to obtain full value or par for its bonds. Indeed, in the majority of cases, the promoters have been compelled to offer bonuses of stock with the bonds to be able to borrow the necessary funds for construction. Eventually, however, bonds must be redeemed at par by the railroad, and the differences between the prices obtained for the bonds and par is a distinct loss to the company. It is a practical cost of construction, and the discount on bonds has been urged in several cases as an item in the "cost of reproduction." In its behalf it is urged that the law should take cognizance of the ordinary financial usages of doing business upon borrowed money, and that if there were no construction of a railroad except with actual cash owned by the builders, practically no railroad in the country would have been built and none could be built in the future except by the great and powerful railroad systems.

As a condition precedent to the allowance of any such item, the court or any other body finding the "cost of reproduction" should first find that the discount was a reasonable one, for the most powerful argument against the discount is that a railroad should not be allowed to capitalize its own lack of credit or poverty against the public. Other authorities urge that while this item is proper, it should be met by amortizing the cost in operating expenses over a series of years equal to the life of the bonds. For instance, assume that $100,000 ten years bonds were marketed at 90, making a discount of $10,000, it is urged that $1000 per year for ten years should be charged off in operating expenses in preference to adding $10,000 to capital account of cost of road.

As usual, judicial authority upon the propriety of this item either in capitalization or by amortization in operating expenses,

[21]Supplement to Annual Report of Railroad & Warehouse Commission of Minnesota (1908) p. 28.

[22]Simpson *v.* Shepard, *supra.*

is scarce. Where the discount has been unreasonable, it has been disallowed;[23] but where it has been first adjudged reasonable, the item has been included.[24] The New York Public Service Commission takes the view that discount is but interest in another form and cannot be considered as cost. The same view was taken in the valuation of the New York, New Haven & Hartford Railroad Company, in which the engineer concluded that the item was really an interest charge and that if the securities could be sold at all, the rate of interest which they carried could be made such that they would sell at par.[25]

In the Minnesota Rate Cases discount was excluded by the Special Master upon the theory that if rate-making is to be based on actual cost, it would seem such costs must be measured by the money necessarily expended in producing the construction without regard to whether those undertaking the enterprise have the same or must borrow for the purpose,—a matter in which the public has no concern.[26]

A discount of even three or five per cent upon the par value of an amount of bonds necessary to rebuild a great railroad system, would be of such proportions that its allowance might effectually prevent any attempts at rate regulation by a state. It may be considered from its refusal to allow discount to be capitalized in the accounts and reports of the railroads made to the Commission, that the Interstate Commerce Commission is inclined to exclude such an item from its estimate of the "cost of reproduction" unless compelled to do so by the courts.

"Cost of reproduction less depreciation" is to be ascertained by the Commission and this element was probably inserted in the Act to meet the views of the Supreme Court in the City of Knoxville case,[27] where the Court pointed out that if the property were valued upon the "cost of reproduction," it would be the "cost of reproduction" anew which would be controlling, whereas the property had been used for many years and had received a large

[23]Lincoln Gas & El. Co. *v.* City of Lincoln (1909) 182 Fed. 926, 929.

[24]Montana, W. & S. R. R. Co. *v.* Morley, *supra;* Columbus Ry. & Light Co. *v.* City of Columbus, Report of Special Master, dated June 8, 1905, Case No. 1206, p. 35, Circuit Court of the United States, Southern District of Ohio.

[25]Report relative to the assets and liabilities of the New York, New Haven & Hartford R. R. Co., Massachusetts Joint Commission (February 15, 1911) p. 88.

[26]Shepard *v.* Northern Pacific R. R. Co., Report of Special Master Otis (Sept. 21, 1910) p. 89.

[27]*Supra.*

amount of wear and tear and was depreciated from its original value when new. There are so many different theories held by the engineers as to the methods of determining the depreciation even after they have agreed, which they do not, as to what depreciation is, that no attempt will be made to discuss their differences, which are those of engineering practice and accounting rather than of law.

In the Minnesota Rate Case, the Supreme Court seems to have decided that depreciation invariably exists as a matter of law, and must be deducted before value can be ascertained, although the Master had specifically found as a fact that in the case of a railroad, the depreciation was more than counterbalanced by appreciation due to the settling of its track and roadbed, called "Adaptation and Solidification" by the Minnesota Railroad Commission. Judge Sanborn in his opinion below, said:

"It is clear that a new railroad may appreciate or depreciate as it grows older. It may be renewed, repaired, and improved day by day and year by year as it is operated, until its embankments become more solid, its culverts and bridges firmer and more reliable, its ties and rails more steadfast and secure, and its rolling stock more seasoned and better adapted to its service and to the railroad it traverses, and until the whole property becomes more valuable than it was when it was first constructed. On the other hand, its embankments and its roadbed may be neglected and permitted to deteriorate by the action of rain, snow, and frost, its ties may be allowed to become partially decayed, its bolts and rails loose, and its rolling stock worn, without adequate repairs, until the entire property suffers great depreciation. Whether at a given time a railroad property is more or less valuable than it would be if it had just been constructed is a question of fact, that in a suit of this nature must be answered by the evidence. That evidence in this case is that the railroads, rolling stock, and appurtenances which constitute the great transportation machines of these companies in Minnesota are in better condition for use, more efficient, more steadfast, better adapted to each other, than if their construction was just completed, that all depreciation has been offset by appreciation, and that values to the amounts here allowed by the master have been added to the values of these properties new, by their age, their repairs, their renewals, their adaptation, and the assured efficiency that comes from constant careful maintenance and operation."[28]

In spite of this specific finding of fact, and that the Minnesota Commission's own valuations contained items to offset depreciation under the heads of "Solidification and Adaptation" for the

[28]Shepard *v.* Northern Pacific R. R. Co. (1911) 184 Fed. 803, 810.

attainment of a seasoned and permanent road bed, Justice Hughes in the Supreme Court disposes of the finding of fact as apparently being contrary to law. It is not asserted that the findings are contrary to the evidence or the weight of evidence. Justice Hughes says:[29]

"We cannot approve this disposition of the matter of depreciation. It appears that the Master allowed, in the cost of reproduction, the sum of $1,613,612 for adaptation and solidification of road-bed, this being included in the item of grading and being the estimate of the engineer of the State commission of the proper amount to be allowed. It is also to be noted that the depreciation in question is not that which has been overcome by repairs and replacements, but is the actual existing depreciation in the plant as compared with the new one. It would seem to be inevitable that in many parts of the plant there should be such depreciation, as for example in old structures and equipment remaining on hand. And when an estimate of value is made on the basis of reproduction new, the extent of existing depreciation should be shown and deducted. * * * And when particular physical items are estimated as worth so much new, if in fact they be depreciated, this amount should be found and allowed for. If this is not done, the physical valuation is manifestly incomplete. And it must be regarded as incomplete in this case. *Knoxville* v. *Knoxville Water Co.* 212 U. S. 1, 10."

This excerpt apparently ignores the special findings of fact that any depreciation was offset by appreciation. How the valuation obtained could be more "complete" cannot well be imagined. If in fact there is depreciation, which is not deducted, manifestly the physical valuation is incomplete. But "if in fact" the roads have not depreciated but are more valuable than when newly constructed, does this decision mean as a matter of law, that nevertheless depreciation must be deducted? If so, it is a very serious ruling for the railroads. Many parts of the plant, although kept in repair, may be, in fact, nearer the end of their life than when newly built, but as an entity, the co-ordinated whole may be worth far more than when first laid down. In any event, "depreciation" will be a serious and important question for the Commission to determine.

The correct valuation of railroad real estate consisting of rights of way, yards and terminals has been perplexing in many cases, due to the increase of the value of the lands from their original cost. In some cases lands now immensely valuable were obtained by railroad corporations by private or public donation. For some

[29]Simpson *v.* Shepard, *supra,* pp. 457-8.

time it was urged that the carrier should be restricted to a fair return upon the initial cost of the lands instead of obtaining the benefit of the unearned increment, or an increment earned in fact largely through the impetus giving to surrounding land values by the location and construction of the railroad itself. The true economic and legal view now is, however, that a public service corporation may consider the increase in value of its real estate as part of the value upon which it is entitled to a reasonable return, inasmuch as the corporation is entitled to a fair return upon the value of its property "at the time it is being used for the public,"[30] and "if the property, which legally enters into the consideration of the question of rates, has increased in value since it was acquired, the company is entitled to the benefit of such increase."[31] Upon the logic of those decisions the value of even donated lands must be included in the valuation and a fair return allowed thereon.

In spite of the flat decisions of the United States Supreme Court, the Interstate Commerce Commission has not viewed with favor the proposition that the increase in value of real estate gives the railroad a right to a corresponding increase in rates, and stated that if such be the law, then railroad rates may never be expected to be lower than they are at present, and that on the contrary, there is an unwelcome promise that the rates will continuously advance. Perhaps as a word of warning to the railroads not to urge the proposition too strongly the Commission further hints that the Government might protect its people by taking these properties at present, instead of waiting thirty or fifty years hence, when they will have multiplied in value ten or twenty fold.[32]

Valuation of railroad rights of way must necessarily consider the question of liability for consequential damages to lands not taken, as well as the cost of condemnation proceedings, and consideration of the fact that railroads frequently are compelled to pay exorbitant prices for necessary real estate. The element of damages depends necessarily upon the greatly diversified facts of each particular case. Consequential damages to land not taken and condemnation fees make the lands purchased, or the valuation of lands upon the basis of the cost of re-acquiring them, far more costly than the normal value of the lands for other purposes.

In the valuation of the railroad rights of way by the Minnesota

[30]San Diego Land Co. *v.* National City (1899) 174 U. S. 739, 757.

[31]Willcox *v.* Consolidated Gas Co. (1909) 212 U. S. 19, 52.

[32]*In re* Advance of Freight Rates, Western Case, *supra*, p. 340.

Railroad Commission, Mr. Morgan, the engineer of the Commission, first obtained the value of the rights of way upon an acreage basis from sales of similar acreage property for farm purposes. He then multiplied the resulting valuations by two to arrive at the value for railroad purposes, and used a multiple of three to arrive at the value of terminals, stating that such a method would in general satisfy the conditions. This method has been allowed by the Commissions of South Dakota, Wisconsin, Washington and Michigan, and received judicial sanction in two recent cases,[33] but this theory has been finally overruled by the United States Supreme Court in its recent decision in the Minnesota Rate Case.

In using the multiple method of valuation, the railroads urge that they are not valuing the land for railroad purposes, but are really ascertaining the cost of purchasing the property anew, or figuring upon the cost of reproducing the property. The difficulty is that such valuations are made upon the theory of the non-existence of the railroad, although the premise of the valuation is that the lands have appreciated over their original condition by reason of that very existence. Justice Hughes holds that inasmuch as the railroads have the governmental power of eminent domain, it would be impossible to assume for the purposes of a judicial finding that the companies would be compelled to pay more than the fair marketable value of their lands. He says:[34]

"It is at once apparent that, so far as the estimate rests upon a supposed compulsory feature of the acquisition, it cannot be sustained. It is said that the company would be compelled to pay more than what is the normal market value of property in transactions between private parties; that it would lack the freedom they enjoy, and, in view of its needs, it would have to give a higher price. It is also said that this price would be in excess of the present market value of contiguous or similarly situated property. It might well be asked, who shall describe the conditions that would exist, or the exigencies of the hypothetical owners of the property, on the assumption that the railroad were removed? But, aside from this, it is impossible to assume, in making a judicial finding of what it would cost to acquire the property, that the company would be compelled to pay more than its fair market value. It is equipped with the governmental power of eminent domain. In view of its public purpose, it has been granted this privilege in order to prevent advantage being taken of its necessities. It would be free to stand upon its legal rights, and it cannot be supposed that they would be disregarded."

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[33]Shepard *v.* Northern Pacific R. R. Co, *supra;* Montana, W. & S. R. R. Co. *v.* Morley, *supra.*

[34]Simpson *v.* Shepard, *supra,* pp. 450-1.

Certainly no more speculative inquiry can be imagined than to undertake to determine what it would cost in condemnation awards, damages and expenses to condemn the New York, New Haven & Hartford right of way between New York and Boston, at the present time, assuming that it was to be acquired anew. It would probably equal the capitalization of the road. To determine accurately consequential damages to private owners would necessitate a consideration of every tract of land from which a part of the railroad right of way was acquired. The difficulties of obtaining any result except an arbitrary guess, which might be unfair either to the railroad or the public, are appalling. The multiple theory, however, is a logical outgrowth of the cost of reproduction standard urged by the courts. Even on the theory of "railroad valuation" it is difficult to ascertain the logic which requires a valuation by reason of an adaptability for a certain purpose, under the doctrine of *Boom Co.* v. *Patterson*,[35] in proceedings of eminent domain, and restricts the value of a right of way perhaps one hundred feet wide and one thousand miles long to that of the surrounding country farm land, totally ignoring the peculiar adaptability of such a remarkable contiguous strip for railroad purposes.

One item only mentioned by Justice Harlan in *Smyth* v. *Ames*,[36] is eliminated from the Act, viz:—"the amount and market value of stocks and bonds." Later authorities show an increasing tendency to disregard the capitalization of a property in ascertaining its present value for rate making purposes. In the earlier cases, interest on bonded debt was considered a fixed charge which at any event the company was entitled to earn, thus to some extent allowing the valuation of the property to be influenced by the amount of the bonded debt.[37] But in recent years the amount of the bonded debt has been rejected as an accurate criterion of the value of the property, due principally to the suspicion of overcapitalization. If the bonded debt be no criterion of value, the amount and market value of the stock must necessarily be worthless as such. The market value of the stock depends somewhat upon its underlying security, but is due principally to dividend records which in turn depend upon the rates charged in the past, and the market value of the stock could not logically be consid-

[35](1878) 98 U. S. 403.

[36]*Supra.*

[37]Chicago & N. W. Ry. Co. *v.* Dey (1888) 35 Fed. 866.

ered in fixing value. Prices may rise or fall from causes which have little or nothing to do with the real value of the property. Moreover, the fiat of a railway commission as to rates may readily cause a cessation of dividends and a depression in value. Surely a state cannot first depreciate the market value of stock by a fiat of a railroad commission, and then assert that the lowered market value of such securities must be taken as a fair test of value. We reach, therefore, the conclusion of President Hadley of Yale University, in the Report of the Railroad Securities Commission:[38]

"In so far as the value of the property is an element in rate regulation the outstanding securities are of so little evidentiary weight that it would probably be of distinct advantage if courts and commissions would disregard them entirely, except as a part of the financial history of the property, and would insist upon direct evidence of the actual money invested and of the present values of the properties."

In New York the right to be a corporation is colloquially known as a franchise. Where, however, the corporation has obtained certain incorporeal rights in certain localities, such as the right obtained from municipal authorities to lay down pipes and mains, or railroad tracks in specific streets, these rights are known as special franchises, and have been made taxable by the State of New York. It is undisputed that such a special franchise is property,[39] often of immense value. Can the value of such franchises be correctly considered one of the additional elements of value of a railroad which must be counted in final valuation? Is the corporation entitled to a fair return upon the value of such a franchise?

The opponents of such a right argue with plausibility that it would be most unjust to allow a benefit previously received from a subdivision of government to be thus capitalized against the public; that the value of an incorporeal franchise depends upon its use, so that if the company had charged high rates in the past, the higher would be the value of the franchise, giving the company a vested right, perhaps by reason of extortionate rates charged in the past. On the other hand, the corporations urge that such franchises are property, which is recognized as such and taxed as such by the public, and that legally the franchises are assets entering into valuation of their properties.

In the litigation over the eighty cent gas law, in New York,

[38]November 1, 1911, p. 38.

[39]People *v.* O'Brien (1888) 111 N. Y. 1.

the complainant company valued its special franchises to maintain pipes and mains in the streets of New York at many millions, upon the theory that the right to maintain such mains was property itself upon which an income return might be demanded. An allowance of $20,000,000 was made by the Special Master. In the court below, Judge Hough, in an exhaustive opinion,[40] questions the propriety of any allowance at all for such an item as being inherently unsound, and illustrates his views by the supposition of a franchise granted to a private person to act exclusively as town crier. He queries whether the crier would be justified in charging two prices for his proclamation—one for his service and one as return or income on his franchise or right to perform the service. Out of deference to what he considered controlling authority, however, Judge Hough included the item, though at a reduced valuation.

The Supreme Court avoided the responsibility of deciding this most important question by deciding that no satisfactory evidence of the value of the franchise had been presented, but inasmuch as upon a prior consolidation of the company's predecessors in 1884, the franchises had been included at the sum of $7,000,000 and stock had been issued upon that valuation with the permission of the State of New York, that the State ought to recognize the value of $7,000,000 as part of the property upon which a reasonable return could be demanded, but stated specifically:—

"What has been said herein regarding the value of the franchises in this case has been necessarily founded upon its own peculiar facts, and the decision thereon can form no precedent in regard to the valuation of franchises generally, where the facts are not similar to those in the case before us. We simply accept the sum named as the value under the circumstances stated."[41]

The Commission must state separately any items allowed for valuation of franchises, and then decide for itself the question undetermined by the Court as to the propriety of the items. Its importance cannot be overestimated when we consider, for example, the value of the special franchise of the New York Central Railroad to enter New York City by viaduct and tunnel to the Grand Central Station.

The question of the valuation of franchises, however, is but part of a greater and most crucial question. Are the railroads to be valued for ratemaking upon a different basis than for taxation

[40]Consolidated Gas Co. *v.* City of New York (1907) 157 Fed. 849.

[41]Willcox *v.* Consolidated Gas Co., *supra*, p. 48.

or commercial usage? Are the railroads entitled to a fair return upon their fair market value as entireties? If so, assuming that the value of all the physical properties of a railroad has been fixed by cost of reproduction less depreciation, original cost, physical inventory, and all other factors, then we face the indisputable fact that the value of a railroad may be, and usually is, greater than the physical value by reason of its established business, its organization, and that it is a "going concern."

The market value of a well equipped, well organized railroad with stable traffic is far in excess of the mere replacement cost of its tangible assets. Indeed, the market value of many roads can be easily shown to be entirely independent of such a cost, but depends almost entirely upon earning capacity. Assume, for instance, that at a cost of $50,000 per mile in rock, a road has been built to serve various mines which are nearly stripped of ore, and that nearby in the prairie a road has been built at a cost of $20,000 per mile which has a permanent source of freight,—will cost of reproduction be considered in ascertaining which of the two is more valuable? Earning capacity, and very nearly earning capacity alone, determines value. Must this fact be ignored in the legal valuation of a railroad for rate-making purposes?

In accepting the nomination for the Presidency, William H. Taft distinguished between "physical" value and "full" value, and "physical" value and "full" value have never been regarded as synonymous.[42]

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[42] "It is clear that the physical value of the railroad and its plant is an element to be given weight in determining its full value; but the value of the railroad as a going concern, including its good will, due to efficiency of service and many other circumstances, may be much greater than the value of its tangible property, and it is the former that measures the investment on which a fair profit must be allowed. Then, too, the question what is a fair profit is one involving not only the rate of interest usually earned on normally safe investments, but also a sufficient allowance to make up for the risk of loss both of capital and interest in the original outlay. The question of rates and the treatment of railroads is one that has two sides. The shippers are certainly entitled to reasonable rates; but less is an injustice to the carriers. * * * The proper conclusion would seem to be that in attempting to determine whether the entire schedule of rates of a railroad is excessive, the physical value of the road is relevant and important but not necessarily a controlling factor."—Letter of William H. Taft accepting Republican nomination for Presidency, 1908.

"It is entirely tenable that the value of an economically constructed, judiciously financed and efficiently managed railway property, or the contra thereof, is not measured by its cost, and, for the instant, it seems necessary to recur to the elementary that cost and value are not synonymous and that the determination of the present value of the physical properties, using reproduction cost as a basis, bears no relation to value

In one of the earlier cases, it was held that a system of rates that looks to a valuation of a railroad fixed on so narrow a basis as the cost of reproduction, ignoring the established business and good will connected with the business and its favorable location, denied to the railroad the protection of the Constitution.[43]

The advocates of the "physical valuation" of railroads do not

in the sense of utility, or as an investment." Supplement, Annual Report Warehouse Commission of Minnesota (1908) p. 31.

"The physical valuation is not a scientific basis for an estimate of the public wealth, because that wealth depends upon the value of the property as a 'going concern' and this depends upon its earning capacity not its physical valuation." Report of Massachusetts Joint Commission on N. Y., N. H. & H. R. R. Co. (Feb. 15, 1911) p. 55.

"We are not fixing the value of a collection of ties and rock and steel rails, but of a railroad equipped and doing business. What is that railroad worth as a railroad for the transaction of a railroad business?" *Re* Advances in Freight Rates, Eastern Case (1911) 20 I. C. C. Rep. 259.

"An established railroad system may be worth more than its original cost and more than the mere cost of its physical reproduction. It has passed the initial period of little or no return to its owners which, of greater or less duration, almost always follows construction and is not infrequently marked by default and bankruptcy. The inevitable errors in its building which finite minds and hands cannot avoid have been measurably corrected, time and effort have produced a commercial adjustment between it and the country it was intended to serve, relations have been established with patrons, and sources of traffic have been opened up and made tributary. In other words, the railroad, unlike one newly constructed, is fully equipped and is doing business as a going concern. It has attained a position after many experiences common to railroad enterprises which entail loss and cost not paid from current earnings, and which correspondingly make for value." Missouri, K. & T. Ry. Co. *v.* Love (1910) 177 Fed. 493, 496-497.

In the report of the Interstate Commerce Commission itself, (1888) p. 64, the Commission states:

"The present value of a railroad property is necessarily very largely a matter of opinion only; it depends upon a vast number of contingencies and uncertainties, a road apparently of great value to-day may soon become worthless by the opening of a competing line having superior advantages, or by the competitive struggle of other lines which operate to reduce the income of all; the value of a railroad largely results from the personal characteristics of its officials; the policy pursued by its directors, whether conservative and economical or aggressive and daring, is a great factor in the determination of the current value of the property; a railroad property is not necessarily worth what it would cost to replace it, and, on the other hand, it may be worth very much more than that,"

and again,

"But what is the value of a railway? Does not that value depend almost wholly upon the rate which it is permitted to charge? If the rates upon a railway system are reduced without thereby stimulating the movement of traffic, the value of the property is diminished. If its rates are advanced without loss of traffic the value of its property is increased. Stated in another way: The value of a railroad depends upon what it can earn upon the basis of a reasonable rate and the reasonableness of a rate depends upon the return it will yield upon the value of the property."

[43]Metropolitan Trust Co. *v.* Houston & Texas Ry. Co. (1898) 90 Fed. 683.

deny that "physical value" is not ordinarily "full value." Senator La Follette, probably its foremost advocate, in his three day speech in the Senate in 1906, admitted that to the appraised value of the tangible assets of a railroad, the value of franchises and of the property as a "going concern" should be added to determine value for taxation or commercially, but urged that there was a broad distinction between valuation for taxation and for ratemaking, in that there was no element of an investment in going concern value.[44]

This argument ignores the fact, that even if it were true that there were no element of investment in going concern value by the original projectors of the road, neither is there any such element of investment in the unearned increment of land valuations, which has been held to be a proper element of value for rate making. Were this original investment feature controlling, the rate of return allowed any railroad would depend upon its original cost, which we have seen is practically irrelevant except where it coincides with the "present value." There is, however, an element of investment in "going concern" value. Attention has been called to the fact that until an established business is acquired, capital invested often earns nothing, and the new venture fails to make operating expenses.[45] Few industries, if any, especially railroads, are self-sustaining from the first day of their operation. Usually the first few years operation fails to produce revenue sufficient for operating expenses, repairs and depreciation, to say nothing of interest on indebtedness or dividends. Practically every one of our great railroad systems was a financial failure at the start. Recently constructed railroads in undeveloped territories, such as the Western Pacific, show that the railroad builder looks to the future, and that for many years until the country is developed, any return upon the initial investment is out of the question. During the time of development there is a loss of interest on the money actually expended, so that the railroad builder does not derive as much advantage from his labor as if he had invested his money in gilt-edged bonds. If rates were to be charged from the beginning sufficient to cover a return on the investment and a fair profit, the first customers or shippers would be compelled to pay rates so exorbitant as to be prohibitive. The proprietors of a newly constructed railroad naturally expect to recoup the

[44]Congressional Record, vol. 40, No. 108, p. 5993.

[45]Pioneer Tel. & Tel. Co. *v.* Westenhaver, *supra.*

losses of interest and profits sustained during the time of development when the road has sufficient customers, when its organization is running smoothly, when its traffic is stable and its operating expenses reduced to normal. Does the law require that the initial losses must be borne by him who furnishes the service, and by a restriction of a right to a return upon the amount of the physical property only, inform the railroad constructor that his early years of struggle shall have no reward? Under such circumstances railroad construction is not an attractive field for capital. It would seem that the losses during the non-dividend-paying period of the road resemble an actual investment, and should be treated as an element of the going concern value.

Going concern value will be difficult to determine, even if included in the total valuation. Certainly to say that the reasonableness of rates depends upon the return they yield upon the fair value of the property used, and that an important factor in the fair value of the property is an item of value based upon earning capacity in the past, makes the determination of the amount to be allowed for "going concern" value puzzling. It must be apparent that in considering the earning capacity to ascertain the value upon which a fair return may be allowed, it cannot be measured by whatever rates have been charged in the past but the earning capacity should be ascertained by other standards, such as the value of the service rendered, or upon the basis of charges for similar services by other railroads, or upon rates averaged over a long period of years, otherwise the roads might have vested rights by reason of past extortionate rates. The conclusion of Justice Hughes in regard to the apportionment of the value of interstate and intrastate railroad property, would apply equally to the determination of going concern value:

"The value of the use, as measured by return, cannot be made the criterion when the return itself is in question. If the return, as formerly allowed, be taken as the basis, then the validity of the State's reduction would have to be tested by the very rates which the State denounced as exorbitant. And, if the return as permitted under the new rates be taken, then the State's action itself reduces the amount of value upon which the fairness of the return is to be computed."[46]

"Fair value," however, must mean "market value." Value is a fixed quantity. Value is indivisible and, logically, the purpose of any valuation should not influence the amount of the valuation.

[46]Simpson *v.* Shepard, *supra*, p. 765.

In any event, it cannot be disputed that in proceedings by the law of eminent domain by the sovereign power to take property from individuals directly by process of law, the owner whose property is appropriated is entitled to the market value thereof as a going concern. This has been recognized since in the case of *National Waterworks Co.* v. *Kansas City*,[47] in a decision by Justice Brewer in the condemnation of waterworks.

In a recent decision of the Supreme Court involving the valuation of another water plant by appraisers who had included an item of $562,712.45 for going concern value of a plant which would cost $6,200,000 to reproduce, the Court said:

"The value in equity and justice must include whatever is contributed by the fact of the connection of the items making a complete and operating plant. The difference between the dead plant and a live one is a real value, and is independent of any franchise to go on, or any mere good will as between such a plant and its customers. That kind of good will, as suggested in *Willcox* v. *Consolidated Gas Co.*, 212 U. S. 19, is of little or no commercial value when the business is, as here, a natural monopoly, with which the customer must deal, whether he will or no. That there is a difference between even the cost of duplication less depreciation, of the elements making up the water company plant, and the commercial value of the business as a going concern, is evident. Such an allowance was upheld in *National Waterworks* v. *Kansas City*, 62 Fed. Rep., 853. * * * No such question was considered in either *Knoxville* v. *Knoxville Water Co.*, 212 U. S., 1, or in *Willcox* v. *Consolidated Gas Co.*, 212 U. S. 19. Both cases were rate cases, and did not concern the ascertainment of value under contracts of sale."[48]

Here the Court seems to hint at a difference in valuation under contracts of sale, or condemnation, and for ratemaking. But must not property be valued when taken indirectly without process of law upon the same basis as when taken directly by process of law? What is the difference between direct confiscation by usurpation and indirect confiscation by reduction of the income from property which permits such a distinction? Moreover, the going concern item is not in addition to or separate and distinct from physical value. The added value has no existence apart from the tangible elements of value. There is only one value,—the value of the railroad as it is being used. As stated previously by the Supreme Court:[49]

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[47](1894) 62 Fed. 853.

[48]Omaha *v.* Omaha Water Co. (1910) 218 U. S. 180.

[49]Cleveland, C., C., & St. L. Ry. Co. *v.* Backus (1894) 154 U. S. 439.

"The value of property results from the use to which it is put and varies with the profitableness of that use, present and prospective, actual and anticipated. There is no pecuniary value outside of that which results from such use."

The Court has as yet, however, refused to decide flatly whether this valuation for rate making must exclude any but the tangible elements of value. In the Knoxville Case[50] an allowance of $60,000 had been made by the Master for "going concern," but the Court specifically refused to decide upon its propriety.

In the Consolidated Gas Case,[51] allowance was made under the name of "good will" for what was perhaps intended for "going concern" value, for the Master recognized the distinction between the ordinary commercial "good will," such as attaches to an old firm name or place of business, and that species of intangible value which comes from the gradual building up of a complete organization in the successful operation of a going concern.[52]

In the Supreme Court no consideration was given to the distinction of "good will" in the old commercial sense and "going concern," but the Court held that "good will" should not be valued by reason of the fact that the company had a monopoly, and that the consumer would resort to the "old stand" because he could not get gas anywhere else. This decision is upon the theory that ordinary "good will" of commercial usage was meant by the phrase, and evidently not the established business value used by the Master and the court below.

Many lawyers regard the most recent decision of the Court in *Cedar Rapids Gas Light Co.* v. *City of Cedar Rapids*[53] as indicating the adoption of a ruling to restrict the valuation for rate-making to the physical properties alone, when that question is so presented that it must necessarily be decided. The court below had particularly excluded allowance of additional amount for going concern value after finding the cost of reproduction. Justice Holmes speaking for the Supreme Court said:[54]

"Then again, although it is argued that the court excluded going value, the court expressly took into account the fact that the plant was in successful operation. What it excluded was the

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[50]*Supra.*

[51]*Supra.*

[52]Consolidated Gas Co., Special Masters Report, U. S. Sup. Ct. Record, vol. 1, 205 *et seq.*

[53](1912) 223 U. S. 655.

[54]P. 669.

good will or advantage incident to the possession of a monopoly, so far as that might be supposed to give the plaintiff the power to charge more than a reasonable price (citing *Willcox* v. *Consolidated Gas Co.*, 212 U. S., 19, 52). An adjustment of this sort under a power to regulate rates has to steer between Scylla and Charybdis. On the one side if the franchise is taken to mean that the most profitable return that could be got, free from competition, is protected by the Fourteenth Amendment, then the power to regulate is null. On the other hand if the power to regulate withdraws the protection of the amendment altogether, then the property is nought. This is not a matter of economic theory, but of fair interpretation of a bargain. Neither extreme can have been meant. A midway between them must be hit."

Here we are back again at the pleasing occupation of finding X, but this time we use the language "steering between Scylla and Charybdis." The Court had an opportunity to settle this vexing question decisively but the only reference to this almost all-important subject in the controversies between the railroads and the commissions over the reasonableness of rates is the paragraph quoted. It may be that the Consolidated Gas decision disallowing good will, and the Cedar Rapids Case foreshadow the decision of the Court upon the point when it is so presented that it must necessarily be passed upon. But if the property is valued upon a basis of reproduction, allowance for going concern could not well be made simply by allowing full value of the cost of reproduction of physical units. That cost would be as great if the property were destined to lie idle,—locomotive, steel rails and freight cars have to be paid for and are worth as much intrinsically from a standpoint of cost of reproduction when not in use as when used to their maximum capacity.

What decision will be made of the matter by the Interstate Commerce Commission is difficult to forecast. Upon their decision will depend largely the future regulation of rates. Many railroad men assert that the appraisal of the physical properties of the railroads will more than equal the amount of their outstanding securities and will prove conclusively that any suspicion of overcapitalization is not well founded. It is interesting to compare the recent judicial valuations in the Minnesota Rate Case with the amount of outstanding securities of the roads valued. True, in the Minnesota Rate Case the valuations of the Master were rejected by the Supreme Court because of the multiple theory of land values and failure to deduct depreciation. How seriously a reassessment of those items would affect the total valuations may

be questioned, but the Master excluded discount, franchises, and going concern value and found only the value of railroad assets of the Northern Pacific Railroad, excluding all stocks and bonds owned by the company, and property not devoted to railroad purposes, and excluded the interest of the Northern Pacific in the Spokane, Portland & Seattle R. R. under construction, or in the Big Forks, International Falls or Minnesota and International Railways. The total capitalization upon April 30, 1908 of the Northern Pacific was: Stock, par value, $215,539,634.99; bonds, par value, $190,256,577.66; total par value, $405,796,392.65; and he found the value of the railroad property to be $452,666,489. The Great Northern, capitalized at $209,962,750, par value stock, and $97,955,939.39 bonds, total $307,918,689.39, was found to have a book cost value of $295,401,213, and would cost to reproduce $457,121,469. These figures of value are pointed to by railroad men as indicating that the mere reproductive value of the railroads of the United States will reach a figure far in advance of their capitalization. Be that as it may, the Commissioners' findings will be eagerly awaited both by the railroads and the investing public, and it is safe to predict that eventually the railroads will regret the bitterness with which they have fought the idea of valuation for the last fifteen years.

To impartial observers it would seem that the faith of the railroad stockholder and bondholder must be pinned to the Interstate Commerce Commission. Valuation cannot be completed too soon for the investing public, nor Congress act too speedily to confer all jurisdiction over the railroads upon the Commission. Millions of ordinary business men in this country would be appalled to be subjected to the control of not one but many governmental agencies —such as the Northern Pacific Railroad, subject to rate regulation by the Minnesota, North Dakota, Wisconsin, Montana, Washington and Oregon Railroad Commissions as well as the Interstate Commerce Commission. Such a state of affairs is intolerable. Railroads, as well as men, cannot serve so many masters.

The investing public, and, perhaps the railroads themselves, do not yet realize the importance of the Minnesota Rate Case decision and the extent to which it places the railroads at the mercy of the various state ratemaking bodies. Whatever may be the result of the valuation of the roads as a whole, successful attack upon a schedule of intrastate rates promulgated upon all interstate roads has been made almost impossible. The great difficulty in all con-

fiscation cases involving intrastate state rates has been in apportioning the value of the road used for interstate commerce and intrastate commerce, for where the business is both interstate and intrastate, the question whether rates fixed for intrastate commerce afford a fair return must be determined by considering separately the value of the property employed in intrastate business and the compensation permitted in that business under the rates prescribed.[55]

In the Minnesota Case the Master obtained the value of the intrastate and interstate property by a division between the freight and passenger business upon the relation of the gross revenue derived from each. This proportionate division of the gross earnings is called by the court a "simple method, repeatedly used," but it meets with the disapproval of the Court, though no other or more accurate method is suggested. The operating expenses were apportioned upon an "equated ton mile basis" in the case of freight expense, and an "equated passenger mile basis" in the case of passenger expense. The Court decided that such general estimates of operating expenses incurred in moving intrastate business were not sufficient, and suggested that accounts or relative cost of intrastate and interstate business, giving particulars of the traffic handled on through and local trains, and giving data from which the extra cost of intrastate business could be determined, might have been kept by the railroads, at least for test periods.

When we consider that the intrastate and interstate passengers enter the same station, buy their tickets from the same agent, ride on the same train, use the same dining car, and are hauled by the same locomotive propelled by the same steam and watched over by the same crew, the task set for the ingenuity of railroad statistical accountants to keep the expense of serving them separate, may be appreciated. No suggestion as to how such accounts may be kept is advanced by the Court, which observes that, although it may be said that this may be a difficult matter, the company having assailed the rates, was bound to establish its case and it was not entitled to rest on expressions of judgment when it had power to present accurate data from which the right conclusion might be drawn. So far, therefore, as the relations of the railroads and the intrastate rates of any particular state are concerned, we cannot but conclude that although resting theoretically within the shadow of the Constitution, the railroads are really from the almost super-

[55]Simpson *v.* Shepard, *supra;* Smyth *v.* Ames, *supra.*

human difficulties of proof which must be surmounted before a state system of intrastate rates will be declared invalid, thrust back to the age of Mr. Justice Field when he wrote the words already quoted,[56] and may yet find in the growing power of the Interstate Commerce Commission, so vigorously combatted in so many hard fought legal struggles, their salvation.

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[56]Pp. 568-9.